ECBC[1] Statement on European Banking Authority (EBA) Industry Questionnaire on the Covered Bond Directive Call for Advice and Update on State of Covered Bond Market

19 August 2024

Industry Road Map Towards Principle-Based Harmonisation and Transparency

The implementation of the Covered Bond Directive in the European Union has crowned a long journey and firm commitment undertaken by the covered bond community, under the leadership and governance of the **European Covered Bond Council (ECBC)**, to align market and supervisory best practices so as to facilitate the optimisation of funding strategies. In parallel, this has helped ensure wider access to capital markets and fostered the opening up of global opportunities for both lenders and investors, whilst benefitting consumers. Against the backdrop of the recent implementation of the Directive, it is of paramount importance to secure legal stability in order to ensure the continued smooth alignment of market best practices, due processes and due diligences.

According to the **European Mortgage Federation (EMF) statistics**, covered bonds finance around 25% of European mortgage loans. Several factors explain their popularity with issuers and investors. Issuers like the ability to diversify their funding sources away from short-term deposits and toward longer-term instruments, which better match the maturity of their mortgage book. Covered bonds are cheaper and often have longer maturities than other funding sources, such as unsecured bank debt. Investors like the additional security that dual-recourse offers to both the issuing credit institution and a cover pool of segregated financial assets, usually prime mortgage loans. Generally, covered bonds show higher and more stable ratings than the issuing banks, and have never defaulted over their long history.

The principle-based approach adopted in the Directive was designed to capture and strike the right balance between both long-standing macroprudential features in national supervisory landscapes and overarching market innovations and mechanisms, thereby representing a form of osmosis to securing harmonisation at the European and global levels. It should be kept in mind that national covered bond markets have been well functioning for many decades and that, in general, investors are satisfied with the current framework, which is characterised by principle-based harmonisation combined with product diversity; therefore, any further harmonisation in the legal framework for covered bonds should take into account the existing differences in terms of insolvency law regimes across Member States.

The focus and strength of finding the right balance has been the critical diversification and reinforcement of the investor base through enhanced transparency and availability of standardised information on collateral assets, legislative frameworks and liability issuances. The global catalyst for this systemic market reaction has been the **Covered Bond Label**[2] initiative, developed by the ECBC alongside its annual **European Covered Bond Fact Book & Statistics**[3], with its focal point being the **Harmonised Transparency Template (HTT)**[4], which provides enhanced levels of transparency for supervisors and investors through dedicated sections on ESG assets amongst others.

Over recent years the covered bond market has crucially evolved towards financial structures with extendible maturities, an instrument conceived to address potential liquidity shortfalls and ensure a last resort to avoid the insolvency of the cover pool. Such structures are well appreciated by all market participants, such as investors and rating agencies, and feature different triggers defined at national levels according to the existing specificities of banking crisis management and supervisory roles. In this context, the ECBC has played an important role in the dialogue with authorities and is proud of its success in helping to ensure a well-functioning principle based extension mechanism. At the end of 2023, around two-thirds of outstanding covered bonds had an extendable maturity. In relation to the above and to avoid any unnecessary and

---

[1] The EMF-ECBC is registered in the EU Transparency Register under ID Number 24967486965-09.
[2] https://www.coveredbondlabel.com/
[3] https://hypo.org/ecbc/publications/fact-book/
[4] https://www.coveredbondlabel.com/htt

European Mortgage Federation
European Covered Bond Council
Rue de la Science 14A, 2nd Floor
B-1040 Brussels – Belgium
T. +32 2 285 40 30
info@hypo.org
www.hypo.org

unwarranted markets' fragmentation (in contrast with the principle of the CBD), it is crucial that the extendable maturity structures and the attached discretions exercised by the Member States will be confirmed in the terms of the EU framework currently in force.

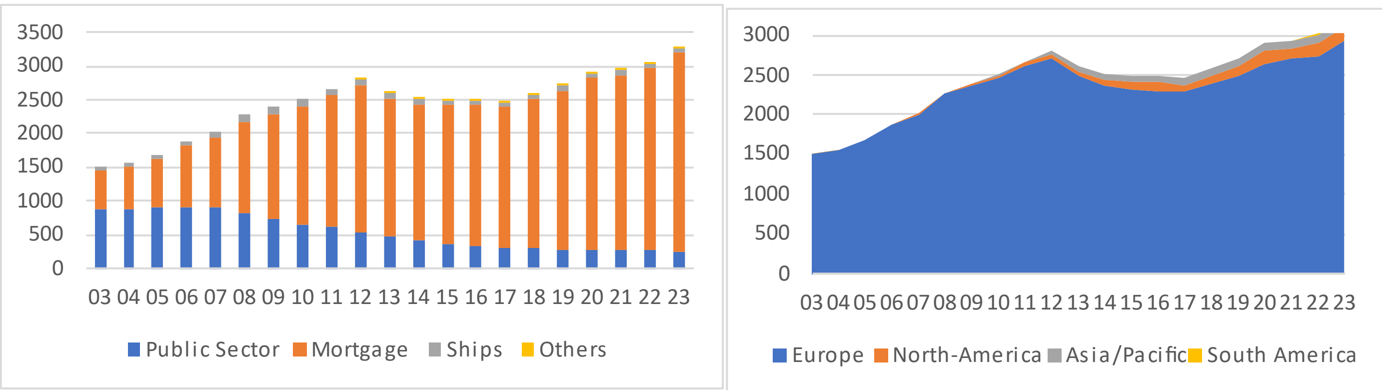
The current political debate regarding the revamp of the **Capital Markets Union (CMU)** initiative comes at a critical geopolitical moment. With financial markets entering uncharted waters and with inflation and a new monetary policy landscape once again highlighting the anti-crises nature of the covered bond asset class, the appetite for a product that can at the same time offer stable and robust long-term financing and efficient asset liability management is evident. Throughout recent years of market turmoil and deposit volatility, lenders have been able to secure access to capital market funding by relying on the more than 250 years old DNA structure of covered bonds' unique characteristics: low volatility, exceptionally low transaction execution risk, superb credit ratings, lower refinancing costs and a reduced need for banks to rely on more expensive funding means and interbank markets, especially during turbulent times. And of course an impeccable credit history throughout the various EU jurisdictions.

In the context of the rethinking of the Capital Markets Union, it is important to underline the macroprudential value and contribution to financial stability of the covered bond asset class. From an investor perspective, covered bonds are already supporting the development of deeper capital markets having achieved a significant degree of granularity, with the value of outstanding covered bonds reaching the peak at the end of 2023 of over EUR 3.3 trn: this is represented by 433 different programmes from 329 active covered bond issuers, of which 77 also issue sustainable covered bonds.

General Remarks On The 2023 Statistics[5]

The aim of the ECBC statistics is to provide the most reliable data on the size and issuance of covered bonds globally. As such, it paints a realistic a picture of developments and trends in the covered bond market. In 2016, a breakdown by maturity structures was added to the statistics, while in 2019, we started to collect statistics on sustainable covered bonds. Sustainable covered bonds include a formal commitment by the issuer to use the bonds' proceeds to (re)finance loans in clearly defined environmental, social, governance (ESG) or a combination of these. The data is based on self-certification by issuers. In the coming years, we will try to further enhance the quality of this data, as we expect that the importance of sustainable covered bonds will continue to grow over time.

Figure 1: Total outstanding covered bond per type (left) as well as by region (right), EUR bn



Source: ECBC, ABN AMRO

Covered Bonds as a Crisis Management Tool: Outstanding Amount of Covered Bonds Increased at Strongest Pace Since 2008

The new record in outstanding of 2023, reflects the large volume of new supply more than compensating for covered bonds that matured during the course of the year. The amount of outstanding covered bonds rose by EUR 230 bn between 2022 and 2023 to EUR 3.3 trn. This was the sixth consecutive year of growth, and the pace of growth (+7.6%) was the strongest

[5] https://storieddata.com/wp-content/uploads/2023/12/Fact-Book-Enhanced.html

since 2008. Moreover, it was more than double the growth rate in 2022 (+3%), taking the volume of outstanding covered bonds further above the EUR 3 trn mark. A breakdown by covered bond type showed that the increase in 2023 was largely due to a rise in outstanding amounts of mortgage covered bonds, as the outstanding amounts of public sector continued to decline in 2023.

Indeed, the nominal amount of mortgage covered bonds rose by EUR 246 bn to EUR 2.9 trn (+9%), while the volume of outstanding public sector covered bonds dropped by EUR 19 bn to EUR 258 bn (-6.8%). The amount of ship covered bonds rose by EUR 0.3 bn and the "other" category, which largely includes export finance covered bonds in Spain, increased by EUR 2.7 bn. Both categories recovered somewhat following a decline in outstanding amounts in 2022. At the end of 2023, the share of mortgage covered bonds in the total amount of outstanding covered bonds was 90%, up from 88.7% in 2022. Meanwhile, the share of public sector covered bonds dropped to 8%, while the share of covered bonds backed by ships/other assets remained stable at around 2.1%. Finally, the share of sustainable covered bonds reached 3% last year, up from 2.6% in 2022 and 1.8% in 2021.

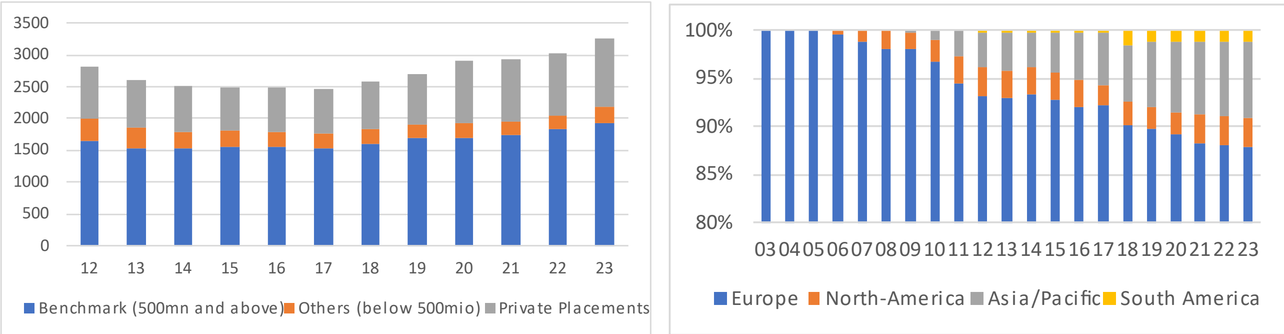
Rise in Both Public and Private Placements

The breakdown between privately placed covered bonds (which includes retained covered bonds also used for central banks' liquidity operations) and publicly placed covered bonds showed that the volume of outstanding covered bonds with a benchmark size (i.e., publicly sold to investors and having a minimum size of EUR 500 mn) increased by more than EUR 110 bn to almost EUR 2 trn, while privately placed covered bonds increased by EUR 94 bn to EUR 1.1 trn. Both series reached their highest levels since we started to publish their statistics in 2012. The rise in privately placed covered bonds was largely due to a French bank that issued EUR 92 bn of retained covered bonds last year after it had set up a separate retained covered bond programme. This new programme replaced other assets (e.g., credit claims) that the bank used in central bank liquidity operations. The move by the French bank had quite some impact on the numbers as it fully reversed the trend seen in the previous two years of a decline in retained covered bonds. The latter was due to banks repaying large amounts of cheap central bank loans that they had obtained following the outbreak of the Covid-19 pandemic. Overall though, the 2023 figures mainly confirm the very important role that covered bonds play as bank wholesale funding tool as well as the role they play in banks' liquidity management.

Covered Bonds Continued Broadening their Global Footprint

Another observation (see below) is that covered bonds continued to broaden their global footprint, as the share of outstanding covered bonds outside Europe increased for the first time to above 10% last year. As such, the figures also underline the growing importance of covered bonds as a bank funding tool, not only in Europe but around the globe. At the end of 2023, 329 covered bond issuers were active around the world, of which 77 also issue sustainable covered bonds. The number of issuers dropped slightly last year, which is due to the balance between issuers leaving the market (mainly due to mergers and take-overs) and new issuers joining the market. Last year, five new issuers entered the covered bond market, while the number of sustainable covered bond issuers increased by double this number. Meanwhile, the total number of countries with outstanding covered bonds remained stable at 34 by the end of 2023, a similar number as in previous years, but more than double the number 20 years ago. The regional breakdown shows that the majority (88%) of all issuers are located in Europe, but that this share is gradually declining. Indeed, the share of issuers from the Asia/Pacific region rose to almost 8% last year, double the share of a decade ago. The share of North America remained at 3% in 2023, while that of South America remained roughly stable at 1.2%. Finally, there were 433 covered bond programmes at the end of the year, as some issuers have public sector as well as mortgage covered bond programmes, while some are using multiple mortgage-backed ones.

Figure 2: Breakdown between public and privately placed covered bonds (left) and Share of covered bond issuers by region (right)



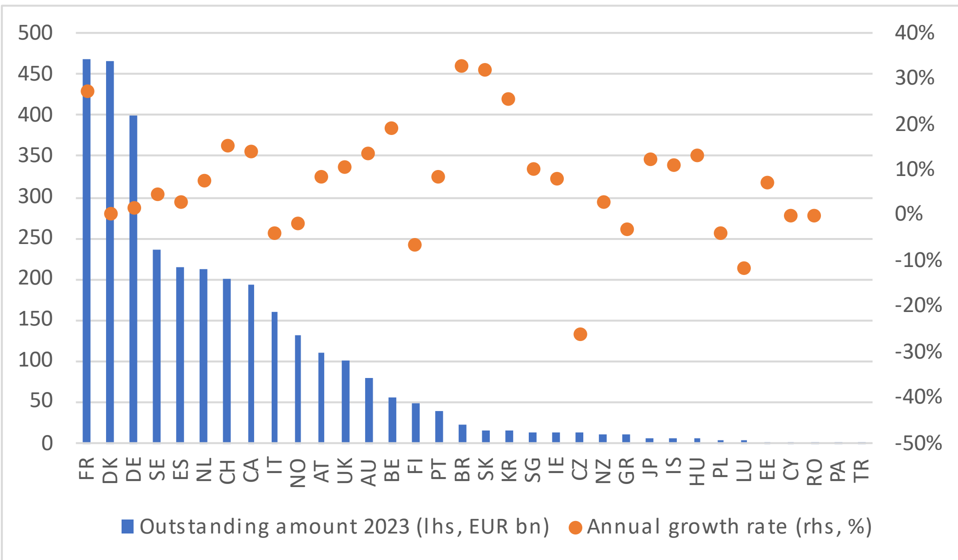
Source: ECBC, ABN AMRO

France Taking the Lead for the First Time

A breakdown by country shows that nine countries had fewer covered bonds outstanding at the end of 2023 compared to 2022, although their decline was more than compensated for by the 23 countries that saw an increase in their outstanding amount of covered bonds. The countries that recorded the largest increase were France (+EUR 101 bn), Switzerland (+EUR 27 bn), Canada (+EUR 24 bn) and the Netherlands (+ EUR 15 bn). In contrast, Italy saw its outstanding covered bonds decline by EUR 7 bn.

The strong increase of outstanding covered bonds in France (to EUR 468 bn) also resulted in the country taking over the top spot from Denmark (EUR 465 bn). This is the first time that France has the largest volume of outstanding covered bonds, as Denmark had led the league table during the past seven years, while Germany was held the top spot from 2003-2015. With France now taking the lead, Denmark dropped to second place, with Germany (EUR 400 bn) third (having been second in 2022). The remainder of the top ten did not change last year.

Figure 3: Total amount of outstanding covered bonds by country and annual change

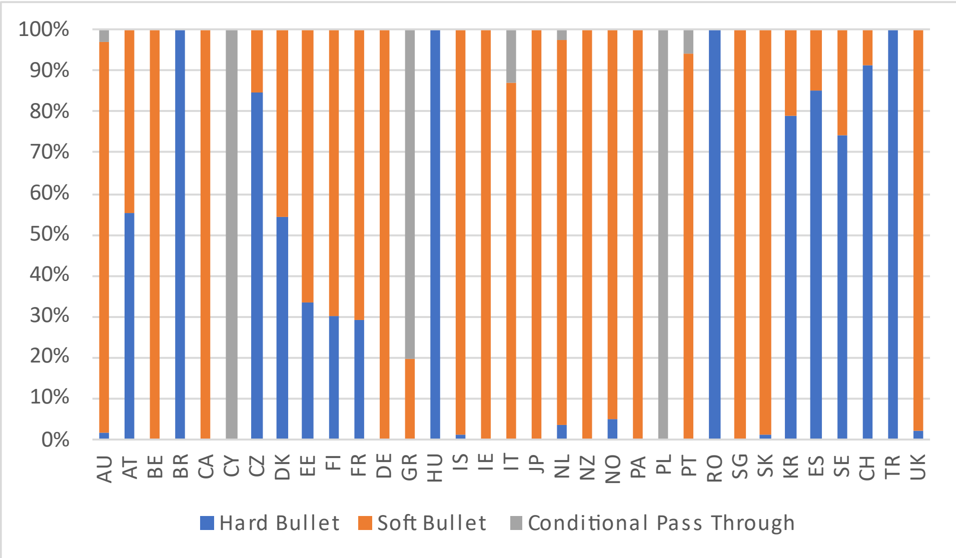


Source: ECBC, ABN AMRO (growth rate of Turkey and Panama are below 50% and not shown in graph)

Soft Bullet Share Above 70%

One of the biggest changes in the statistics seen over the past few years was the increasing dominance of soft bullet covered bonds, a market trend that was further supported by the implementation of the Covered Bond Directive, which has resulted in more and more countries allowing (and issuers using) the structure. In terms of amounts outstanding, soft bullet covered bonds recorded an increase of EUR 246 bn in 2023, while hard bullet covered bonds and conditional pass-through covered bonds posted declines of EUR 7 bn and EUR 9 bn respectively. Consequently, the share of soft bullets rose to 66% of all outstanding covered bonds (from 62% in 2022). The share of hard bullet covered bonds dropped to 33% (compared to 36% in 2022 and 40% in 2021), and that of conditional pass-through (CPT) covered bonds fell to 1.3% (which is half the share of a few years ago, largely reflecting CPT issuers shifting to soft bullet covered bonds). Figure 4 shows that in six countries, hard bullet structures still represent at least 90% of the outstanding amount of covered bonds, while this is the case in 15 countries for soft bullet covered bonds. It is worth mentioning that with the implementation of the CBD, all German hard bullet issuances switched [by law] to soft bullet. With an increasing number of countries allowing for soft bullet covered bonds, this share is likely to rise further in the coming years.

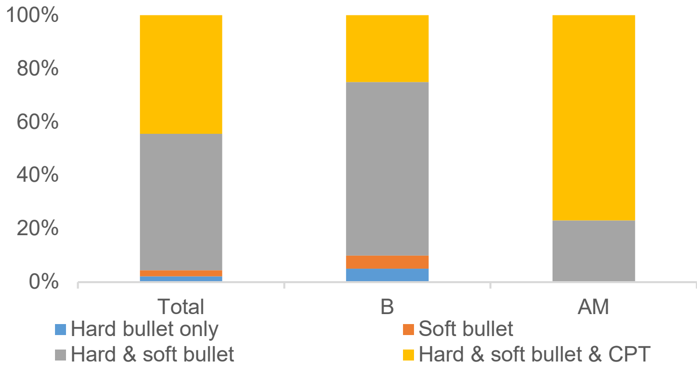
Figure 4: Outstanding covered bonds by maturity and country (%)



Source: ECBC, ABN AMRO

Virtually all investors surveyed for the ECBC Fact Book 2024 are able to invest in covered bonds with extendable maturities (a mere 2% cannot do so). However, there is a stark contrast between those who can invest across the spectrum all the way to conditional pass through (CPT) covered bonds and those for which it ends with soft bullets. This is especially so amongst bank treasury investors where CPT structures are not as commonly accepted as is the case for asset managers.

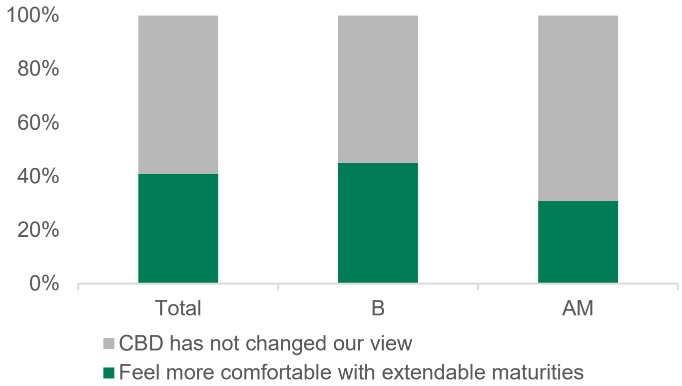
Figure 5: ECBC Fact Book 2024 investor survey: "In which maturity structures are you able to invest?"



Source: Crédit Agricole CIB

The additional clarity around extendable maturities that the Directive has provided was seen positively by around 40% of respondents. For 60%, additional clarity around, for example, extension triggers has been broadly neutral as they were comfortable with the pre-existing market standards already.

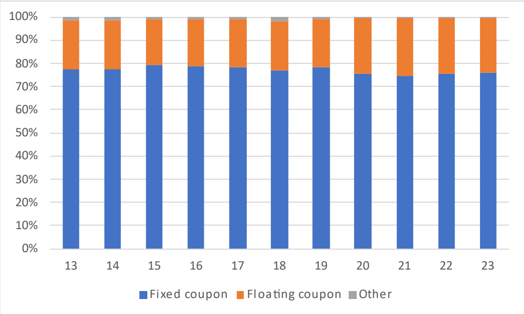
Figure 6: ECBC Fact Book 2024 investor survey: "Post the Covered Bond Directive's implementation, how comfortable are you with soft bullet maturities in covered bond markets?"

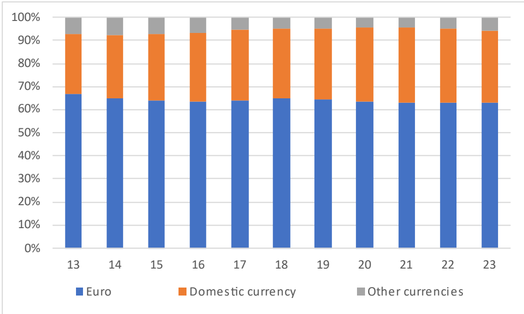


Source: Crédit Agricole CIB

The breakdown of outstanding covered bonds by coupon type as well as by currency type again remained fairly stable in 2023, with the share of floating rate covered bonds slightly declining. The fixed rate coupon remained the standard (76%), reflecting that almost all publicly placed benchmark covered bonds in EUR have a fixed coupon. Meanwhile, the euro remains the dominant currency (63% share of the total), followed by domestic currencies (31%). Interesting to note is that the outstanding amount of covered bonds denominated in other currencies (i.e. not in euro or in an issuer's domestic currency if not the euro) continued to grow strongly in 2023. In fact, the amount of outstanding covered bonds in this category increase by EUR 47 bn to almost EUR 200 bn. This translated into a growth rate of 31%, up from 14% in 2022. This category's share rose to 6% of the total (from 4.3% three years ago). This means that issuers increasingly enter other markets than their domestic markets (be this the euro market or another market), which is another confirmation that the covered bond market is becoming increasingly more global.

Figure 7: Outstanding covered bonds by coupon type (left) and currency (right)





Source: ECBC, ABN AMRO

Covered Bonds from an Investors' Perspective

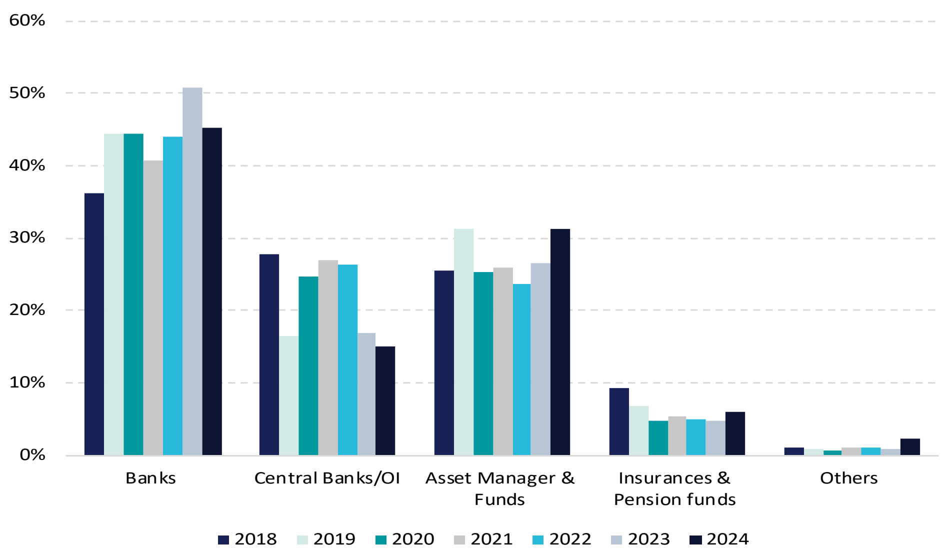
Covered bonds thrive when issuer and investor incentives are properly aligned. Banks find covered bonds even more attractive when their lending to the real economy via their mortgage book is growing and alternative funding options are limited. This was the case for many issuers in Europe after the financial crisis, as well as for global jurisdictions like Canada and Australia. Here, customer deposits financed a limited percentage of domestic loans by international standards and alternative sources of funding, such as securitisation, proved to be less reliable than before within periods market turmoil. Banks are still the dominant investor category in all tenors of CB, followed by asset managers and funds. As mentioned, Central Banks considering reduced their share in 2022 and 2023, as a consequence of the shift in monetary policy and winding down of the Targeted Long-Term Refinancing Operation (TLTRO). Worth noting that insurers have a big share as subscribers of long tenors (>10 years, with a share of 23% of the total in 2023).

In an investor survey undertaken for the 2024 edition of the ECBC Covered Bond Fact Book, all investors took a neutral or even positive view on the Directive. The majority also said that the implementation of the Directive had been neutral for their view on covered bond spreads, highlighting that spreads are not only driven by harmonisation of the legal framework but also by sovereign, credit and structural aspects.

Asset managers and credit investors have been driving demand for covered bonds in 2024 (Figure 8), enticed by improving liquidity, high yields and higher spreads on offer. In 2024, they have become more active in covered bonds with maturities of 7-10y (Figure 9) and those from periphery/high-beta issuers. We note that bank treasuries have been buying covered bonds consistently since June 2022 and are taking a more selective approach. This has pushed central banks/official institutions back into the spotlight as the marginal buyers of covered bonds (especially up to 7y). National banks within the Eurosystem (e.g., in France and Germany) are still quite actively buying covered bonds for their reserves and pension fund portfolios.

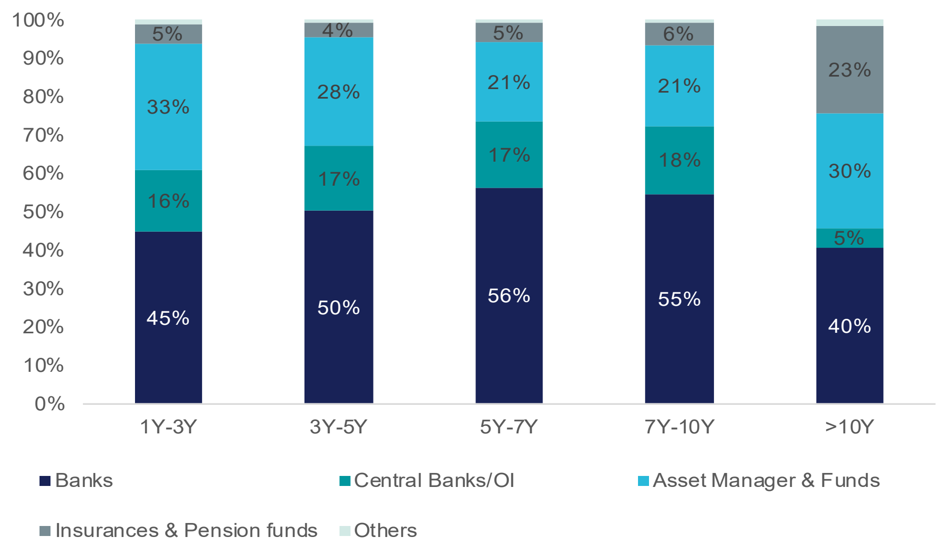
In terms of demand by geography, the German investor base is the largest, but with increasing cross border funding activity, the investor base is becoming more global. And with increased transparency emanating from the Directive and Art. 14, investors are looking to diversify and have access to different jurisdictions, mortgage markets, provided they are compensated for the additional risk they take.

Figure 8: Banks still have largest investor share (2024 ytd)



Source: Market Data, Nord/LB

Figure 9: Investor distribution by initial maturity bucket (2024 ytd)



Source: Market Data, Nord/LB

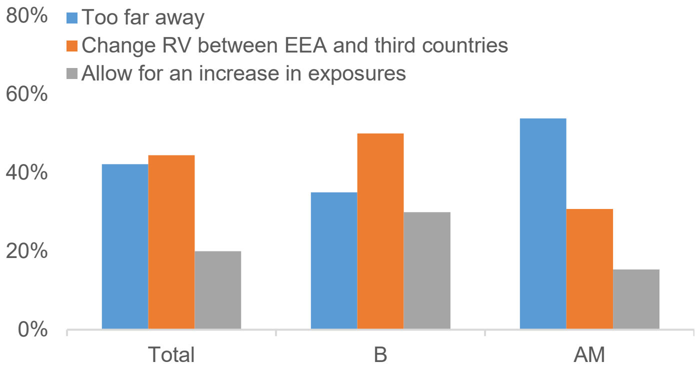
Widely recognised as a solid, anti-cyclical, long-term financing instrument, covered bonds have become a central pillar of financial stability in Europe and beyond, and form the nexus between harmonised European financial innovation and the traditions that sit within different national legal frameworks. Through the harmonisation and convergence brought about by the entry into force of the Directive and the ongoing pursuit of Basel Committee on Banking Supervision recognition of covered bonds, the covered bond industry continues to broaden its geographical horizons. This could be further enhanced in the near future by third-country equivalence for non-EEA countries.

In the ECBC Fact Book 2024 investor survey, third country equivalence was seen as still too far away for now, however, bank treasuries especially with new third country equivalence regimes would be open to increase their exposure further beyond the already sizeable holdings of covered bonds from countries such as Canada. This would also change the relative

European Mortgage Federation
European Covered Bond Council
Rue de la Science 14A, 2nd Floor
B-1040 Brussels – Belgium
T. +32 2 285 40 30
info@hypo.org
www.hypo.org

value scheme between European and third country covered bond segments given the potentially reduced regulatory costs of holding them for banks.

Figure 10: ECBC Fact Book 2024 investor survey: "What is your view on covered bond third country equivalence as foreseen in the Covered Bond Directive (multiple answers possible)?"



Source: Crédit Agricole CIB

In the meantime, the Covered Bond Label offers investors a transparent global toolbox to facilitate their due diligence and comparability regarding legislative/supervisory frameworks, cover asset quality and liabilities.

The capacity to ensure access to capital markets is one of the most profound strategic assets of the European Union, impacting the positioning of "System Europe" in the global arena in terms of competition, sustainability and leadership.

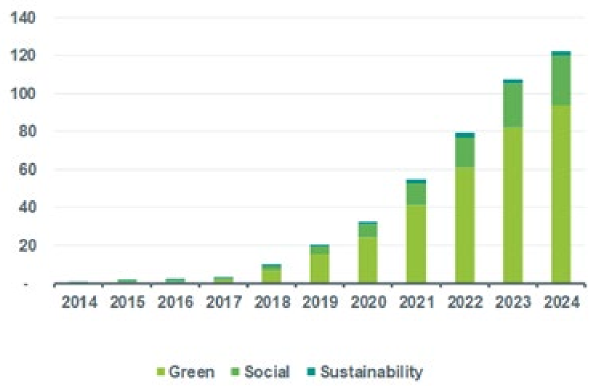
The Market for Sustainable Covered Bonds

The market welcomed the first sustainable covered bond in 2014 (issued by MünchenerHyp), followed by an inaugural green euro benchmark covered bond in 2015 (issued by Berlin Hyp). Furthermore, the first social covered bond was also issued in 2015. The market for sustainable covered bonds has continued to expand ever since, breaching the EUR 100 bn mark in 2023. By the end of June 2024, the volume of outstanding sustainable covered bonds was above EUR 120 bn.

Sustainable covered bonds are issued in different formats, ranging from green, social, and sustainability covered bonds. The different flavours reflect the different use of proceeds of the bonds. In short, **green covered bonds** are mostly aligned with the ICMA's Green Bond Principles[6], and in some cases they also already comply with the EU Taxonomy with the proceeds of the bonds being used to (re)finance green projects. In the case of covered bonds these are often linked to energy-efficient buildings. **Social covered bonds** are mostly aligned with the ICMA's Social Bond Principles[7]. The proceeds of these bonds are used to (re)finance social projects, which in case of covered bonds is largely related to affordable housing or public lending, such as for hospitals etc. Finally, **sustainability covered bonds** are aligned with the ICMA's Sustainability Bond Guidelines[8], and they tend to be a mix of green and social projects, for instance, energy-efficiency as well as affordable housing. Green covered bonds form the majority of outstanding sustainable covered bonds, with a 76% share at the end of June 2024. Social covered bonds had a 22% share and sustainability covered bonds a 2% share (see Figure 12). The share between the different categories has remained fairly stable since 2019.

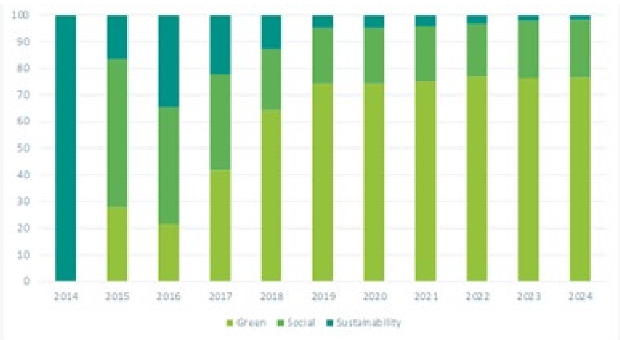
[6] https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/green-bond-principles-gbp/
[7] https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/social-bond-principles-sbp/
[8] https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/sustainability-bond-guidelines-sbg/

Figure 11: Outstanding amount of sustainable covered bonds, EUR bn



Source: ECBC, ABN AMRO, Bloomberg, 2024 data covers H1

Figure 12: Share of green, social and sustainability covered bonds in total, %



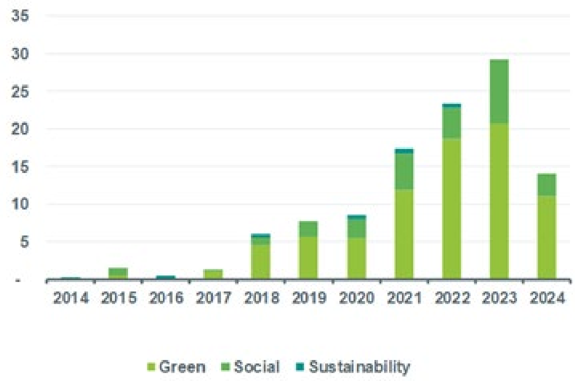
Source: ECBC, ABN AMRO, Bloomberg, 2024 data covers H1

New Issuance of Sustainable Covered Bonds Gaining Momentum

The sustainable footprint of the covered bond market has grown over the years, with new supply having gained real momentum since 2018, setting new records every year. In 2023, new supply of sustainable covered bonds across different currencies reached a volume of almost EUR 30 bn, which was another record. In the first half of 2024, issuance of sustainable covered bonds is already more than half the total amount issued in 2023, implying that the market has continued to expand at a solid pace this year too.

A breakdown by covered bond type shows that the majority of sustainable covered bonds is backed by mortgages (94% of the amount outstanding), with the remaining 6% backed by public sector loans. This mirrors the fact that most sustainable covered bonds are green bonds, financing energy-efficient buildings. Indeed, Figure 14 shows that 96% of green covered bonds are backed by mortgages. This share drops to 84% for social covered bonds, which reflects that public loans tend to have more often a social character. Finally, regarding currencies, the euro accounts for around 75% of total outstanding sustainable covered bonds, while there are also AUD, CHF, DKK, GBP, HUF, NOK, PLN, SEK, and USD denominated sustainable covered bonds.

Figure 13: New issuance of sustainable covered bonds, EUR bn



Source: ECBC, ABN AMRO, Bloomberg, 2024 data covers H1

Figure 14: Sustainable covered bonds by collateral type

Source: ECBC, ABN AMRO, Bloomberg, 2024 data covers H1

Focusing on the iBoxx euro benchmark covered bond index and taking the June 2024 composition, the total amount of sustainable covered bonds in the index grew from EUR 20 bn in June 2023 to EUR 85 bn in June 2024. This is 8.9% of the total index, which is up from 7.2% a year ago, and more than triple the share three years ago. Of these, EUR 62.4 bn were green covered bonds (6.6% of total index). The share of sustainable euro covered bonds seems on a path to reach a 10% share in the total index in the not-too-distant future, confirming that sustainable covered bonds are becoming less of a niche product, and also underlining the importance that covered bonds can play in financing the energy transition. Indeed, the share of sustainable covered bonds in total issuance of euro benchmark covered bonds was just above 10% in H1 2024. The clarity about what can be classified as energy-efficient buildings within the EU taxonomy, and therefore the mortgages that can be financed by issuance of green covered bonds, is likely to further support issuance of sustainable covered bonds in the coming years.

Market Innovation as a Driver for CMU Opportunities and Synergies

In the context of the implementation of Basel III, securing a level playing field for lenders and investors is critical to allowing the banking system to finance the breadth of the real economy in Europe, particularly for households, small and medium sized enterprises (SMEs) and public sector financial services.

The existence of a competitive banking sector channelling private investment will reduce the need for public sector interventions, especially in supporting a transition economy. This would allow for the reduction of pressure on European tax payers in strategic sectors such as housing, public finance, ships and SMEs.

The desire to combine the development of new market solutions whilst securing common market best practices rooted in macroprudential features for critical asset portfolios like mortgages and SMEs was the reasoning behind the European Secured Notes (ESN)[9] initiative. This combines existing covered bond dual-recourse techniques and best market practices aimed at establishing a funding solution – framed by an EU legislative initiative - for lenders and a new product for institutional investors, which would also be accessible in a stress scenario acting as an anti-cyclical funding tool providing support for the real economy. SMEs represent the backbone of the European economy, as shown by the numbers in 2023[10] (see Figure 15).

Figure 15: Strategic significance of SME sector, data for 2023

Class size	Number of enterprises		Number of persons employed		Value added	
	Number	Share	Number	Share	**Billion €**	Share
Micro	22 744 173	93,5%	38 790 351	29,4%	1419,4	18,6%
Small	1 332 200	5,5%	25 602 334	19,4%	1259,8	16,5%
Medium-sized	204 786	0,8%	20 493 722	15,5%	1266,5	16,6%
SMEs	24 281 159	99,8%	84 886 407	64,4%	3945,8	51,8%
Large	43 112	0,2%	46 918 978	35,6%	3673,8	48,2%
Total	24 324 271	100,0%	131 805 385	100,0%	7619,6	100,0%

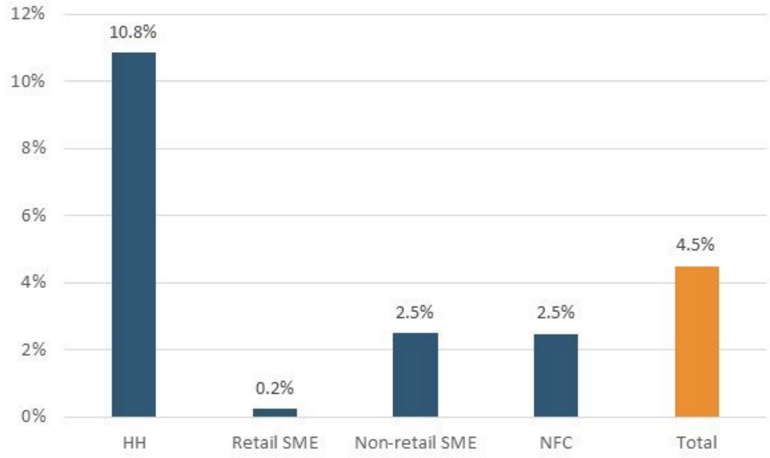
Source: European Commission

Considering their crucial contribution to the EU's competitiveness, SMEs need to be safeguarded by ensuring that a continuous flow of investment can be directed to them, through both bank and non-bank funding. Coupled with other features of the envisaged Capital Market Union, such as channelling private investments to the corporate sector, this could help bridge the competition gap that the EU has with other regions of the world.

Market-led developments such as the Covered Bond Label HTT and the Energy Efficient Mortgages Initiative have contributed significantly to building a strong market due diligence ethos. This has helped to enhance disclosures and allow for the inclusion of regulatory novelties such as taxonomy best practices, which has made the housing sector the greenest asset class in the single market. Furtehrmore, we believe that the potential development of green ESNs could spur a similar market evolution in the same way that green loans for housing have demonstrably benefitted from the introduction of green covered bonds (fostered by the inclusion of ESG data in the HTT). Moreover, this could boost the greening of SMEs, which are currently lagging behind in terms of green investment as indicated in the EBA report on Green Loans and Mortgages[11] (Figure 16).

[9] https://hypo.org/ecbc/market-initiative/european-secured-note/
[10] https://single-market-economy.ec.europa.eu/document/download/b7d8f71f-4784-4537-8ecf-7f4b53d5fe24_en?filename=Annual%20Report%20on%20European%20SMEs%202023_FINAL.pdf
[11] https://www.eba.europa.eu/sites/default/files/2023-12/e7bcc22e-7fc2-4ca9-b50d-b6e922f99513/EBA%20report%20on%20green%20loans%20and%20mortgages_0.pdf

Figure 16: Share of green loans in total loans by business line



Source: European Banking Authority report on Green Loans and Mortgages

In terms of the potential appetite from stakeholders involved in the development of ESNs (issuers, investors and SMEs), it is important to highlight two main points:

1. On the issuers' side, the appetite to start issuing ESNs as a recurring programme based financing tool is growing. This comes in light of the recent inflationary context with rising interest rates which proved challenging for European businesses and even more so for SMEs, especially after the winding-down of the Targeted Long-Term Refinancing Operation (TLTRO) by the European Central Bank (ECB), which allowed for many years of affordable SME financing and also the unrated corporates treatment in the recently approved Capital Requirements Regulation (CRR). In this context, ESNs would be used as a multiple-purpose instrument: a recovery tool when the EU economy is under stress, and in more stable times as an instrument to respond to competitive challenges at the global level for European SMEs, which are mostly export-orientated, as well as leverage to channel ESG investments for SMEs.
2. Due to their financial structure, ESNs would be positioned between covered bonds and securitisation in terms of yields, creating an interesting investment product for institutional investors.

Drawing on a traditional background and by introducing innovation rooted in sound supervisory and legislative frameworks, ESNs have the potential to serve as a market catalyst and offer investors an additional means to develop deeper and broader CMU opportunities whilst respecting the recognised specificities of the covered bond and securitisation sectors. The ECBC established a specific task force elaborating proposals and a blueprint[12] for ESN and its potential regulatory recognition.

In the context of the rethinking of the Capital Markets Union, it is important to underline the critical complementarity in securing optimisation of access to capital markets played by both covered bonds (together with ESN) and securitisation, two key mechanisms for bank funding and capital market development, albeit each with distinct structures, risk profiles and regulatory frameworks. Covered bonds are a strictly regulated financing instrument where credit risk remains in the banking book and is managed by the issuer, even after its insolvency, whilst the investor has a dual recourse claim on both the issuer itself and the cover pool. In the case of securitisations, a portion of the credit risk is transferred to investors and, upon certain triggers being met, the management of the portfolio generally passes to a third-party. In the context of the current political debate, these instruments play unique but mutually reinforcing roles in the financial ecosystem offering:

1. **Diverse Funding Sources:** Covered bonds and securitisation provide banks with diverse funding options. Covered bonds offer stable, long-term funding with lower risk, while securitisation allows banks to offload a high variety of assets and free-up regulatory capital.

[12] https://hypo.org/ecbc/market-initiative/european-secured-note/

2. **Market Stability and Resilience:** The dual recourse nature of covered bonds contributes to financial stability, particularly in times of crisis. Securitisation, by distributing risk across a broad base of investors, enhances market resilience through accrued risk sharing and supports credit availability, where a specific prudential framework is in place to take into account the diversity of the product.

3. **Enhanced Liquidity:** Both instruments contribute to market liquidity. Covered bonds are typically highly liquid, making them attractive for institutional investors. Securitisation can create liquidity for less liquid asset classes, broadening access to capital markets.

4. **Investor Diversification:** The different risk profiles and structures of each asset class attract a wide range of investors, from conservative to risk-seeking. This diversification of investor base enhances the robustness and depth of capital markets.

5. **Regulatory Balance:** Fair regulatory frameworks for both covered bonds and securitisation under the CMU ensure high standards of transparency, quality and investor protection, fostering trust and participation in European capital markets, taking into account the specificities of the two instruments. Every regulatory treatment and change should always be based on an adequate risk assessment.

6. **SME Financing:** ESN and SME securitisation are mutually complementary as ESNs would be issued on the basis of an issuance programme, therefore acting as a resilient funding instrument for SMEs, especially in times of market volatility where issuers can react quickly according to the economic context, whereas securitisations would finance SMEs through investors' differing risk appetites and would be issued via stand-alone transactions in periods of market stability. Furthermore, ESNs are also complementary to the important on balance sheet SME securitisations, which are currently allowing banks to off-load portions of their regulatory capital, ensuring new lending to the real economy.

7. **Economic Growth:** By improving access to finance for banks and businesses, both instruments support economic growth. Covered bonds provide stable funding for mortgages and public sector projects, while securitisation may facilitate credit for a whole range of economic sectors, including SMEs and consumer lending.

ECBC Policy Considerations

With a view to systemically reinforcing financial stability and supporting the real economy, the ECBC stands ready to take leadership in the development and promotion of market initiatives that could maximise the complementarity of covered bonds, ESNs and securitisation. In the context of the CMU debate, this complementary set of options for both investors and issuers would support the transition economy. Against this background, market participants' minds could be focused on:

- **Promoting Harmonisation**: Continue to work with market initiatives like the Covered Bond Label and its HTT. They are driving harmonisation across markets at a global level, thereby enhancing transparency with standards and disclosure best practices, promoting market confidence and facilitating compliance due diligence.

- **Supporting Innovation**: Encourage innovation in both asset class markets to adapt to changing financial landscapes and meet diverse funding needs. Market innovations such as extendable maturities, green covered bonds and European Secured Notes (ESNs) represent intellectual innovations which have allowed the Industry to adapt and perform robustly in a changing market and regulatory environment, with unprecedent policy dynamism.

- **Monitoring Risks**: Maintain robust supervisory frameworks to monitor and manage risks associated with both instruments, ensuring financial stability.

Conclusions

In summary, covered bonds remain a central means to help guarantee the resilience of EU capital markets and it is therefore fundamental that the current specificities upon which this strength is founded are preserved going forwards. In addition, European Secured Notes and securitisation can play complementary roles in the further development of the CMU, by providing diversified funding options and by enhancing market stability whilst supporting economic growth. By leveraging on the unique strengths and prudential regulation of each asset class, the CMU can give rise to a more integrated, more resilient and more efficient European capital market, which will be capable of financing the competitiveness of the EU in the years to come.

This strategic complementarity also offers unique value in terms of the ability of these asset classes to support the transition to a climate-neutral economy due to their pivotal role in forging a path to sustainable growth, stability and shared prosperity. With its 3 trn of bonds outstanding, the covered bond market continues to expand and evolve towards financing sustainable sectors, transcending borders and bridging gaps between capital markets and the real economy.

The intellectual leadership and market governance guaranteed by the ECBC through its analysis and proactive coordination of market developments encompasses the essence and collaborative spirit of the ECBC members' work, which amalgamates different cultures, perspectives but - more importantly - legal and financial features into a common qualitative and quantitative perimeter. Over the years, this approach has become the true *fil rouge* of our Industry's *modus operandi*, always ready to adapt to challenges whilst preserving asset quality and investor protection.

In this way, our community has fostered a covered bond philosophy with clear macroprudential characteristics, ensuring capital market accessibility and financial stability for mortgage and housing markets.

During more recent periods of market turmoil, pandemic and technological innovation, the wider EMF-ECBC community has played a prominent role as a market catalyst. Through its working groups, technical committees and task forces, the EMF-ECBC has developed unrivalled technical knowledge and centres of competence in relation to the mortgage and covered bond businesses in Europe and beyond. By employing a think-tank approach and adopting a clear global market governance structure, the EMF-ECBC leverages this expertise to minimise market disruption, whilst delivering active coordination and implementation of initiatives such as those cited above and through the Energy Efficient Mortgages Initiative (EEMI)[13] or the Energy Efficient Mortgage Label (EEM Label)[14] and its Harmonised Disclosure Template (HDT)[15].

The EMF-ECBC remains at the disposal of the European Banking Authority and the other European Institutions to share its expertise in the covered bond and mortgage credit sectors with a view to ensuring a strong, stable and sustainable future for all stakeholders.

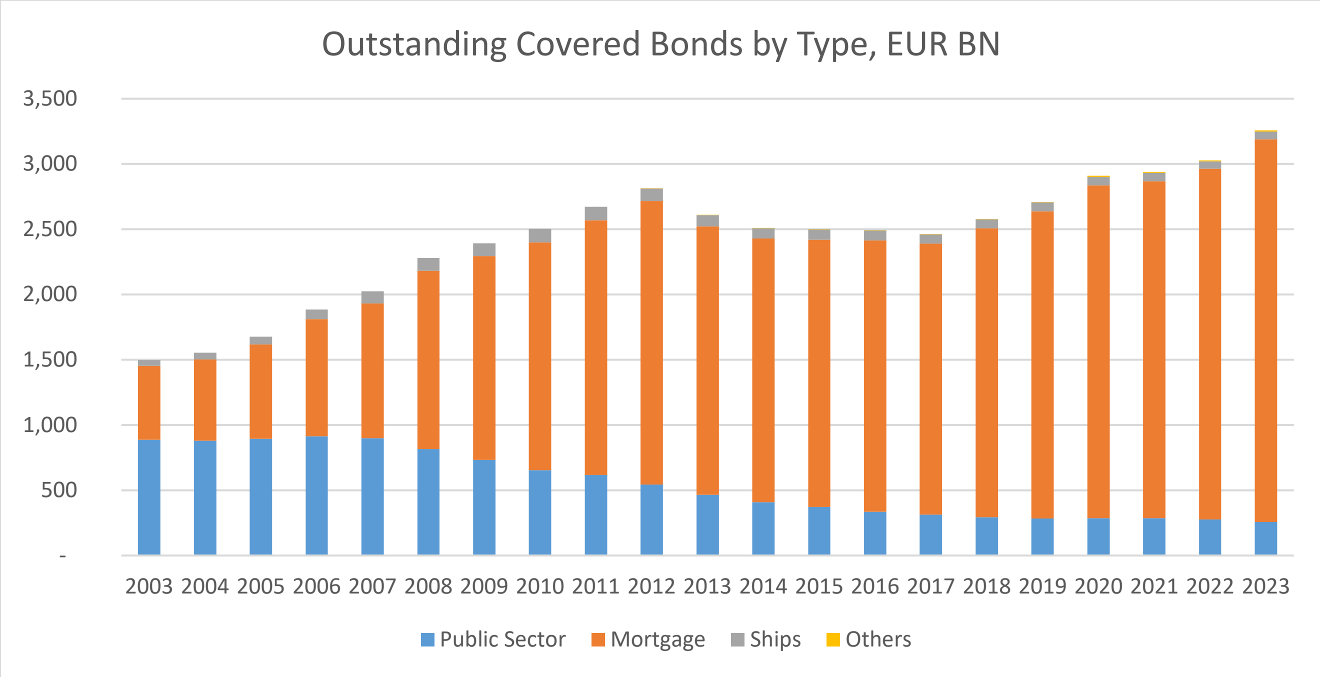
For further information about:

- **ECBC**: https://hypo.org/ecbc/
- **European Secured Notes (ESNs)**: https://hypo.org/app/uploads/sites/3/2024/08/ECBC-ESN-Blueprint-July-2024.pdf
- **ECBC European Covered Bond Fact Book**: https://hypo.org/app/uploads/sites/3/2024/08/FactBook-2024_web.pdf
- **ECBC Statistics**: https://hypo.org/app/uploads/sites/3/2024/08/Statistic.pdf
- **EMF Hypostat:** https://hypo.org/app/uploads/sites/3/2024/08/HYPOSTAT-2024_web.pdf

[13] https://energyefficientmortgages.eu/
[14] https://www.energy-efficient-mortgage-label.org
[15] https://www.energy-efficient-mortgage-label.org/hdt

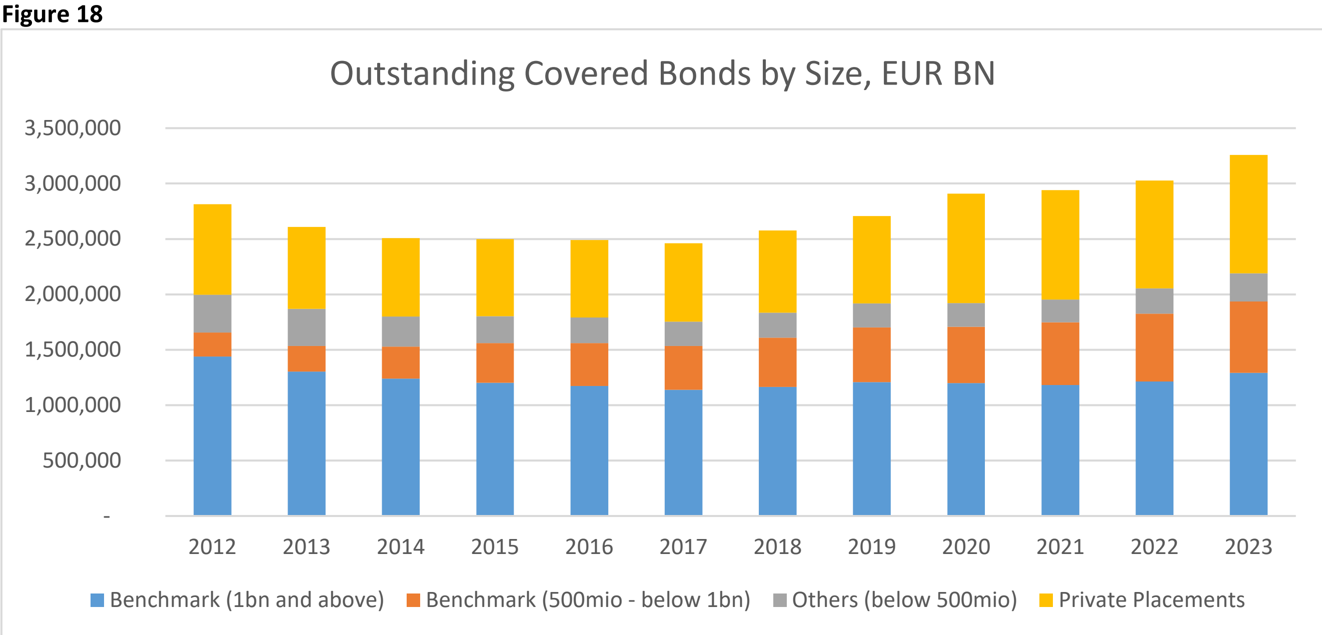
Statistical Annex

Figure 17



Source: ECBC

Figure 18



Source: ECBC

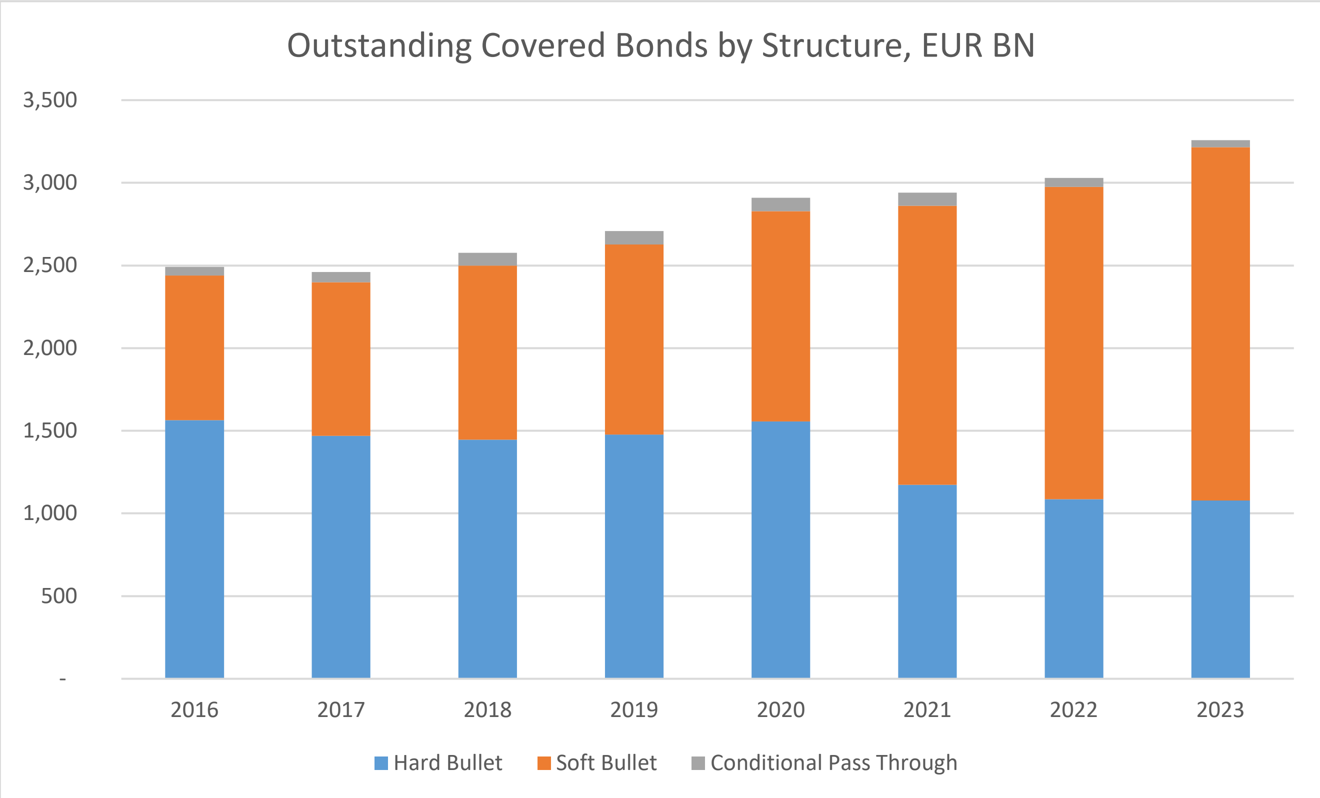
European Mortgage Federation
European Covered Bond Council

Rue de la Science 14A, 2nd Floor
B-1040 Brussels – Belgium

T. +32 2 285 40 30
info@hypo.org

www.hypo.org

Figure 19



Source: ECBC